Meeting the Energy Challenge

stabilization • conservation • generation

Governor Gray Davis

July 6, 2001

California's energy crisis is one of the most serious challenges our state has faced in decades.

While the crisis began in the West, its widening impact will affect businesses and consumers all across this country. This is a national economic issue.

As Federal Reserve Chairman Alan Greenspan observed earlier this year, "It is scarcely credible that you can have a major economic problem in California which does not feed to the rest of the 49 states."

The good news is that California's energy problems can be solved. And the state is doing everything within its power to solve them.

As far back as April 1999, Governor Davis began implementing a comprehensive long-term energy plan. Today, that plan is bearing fruit: more power, lower demand, less reliance on the volatile spot market and reduced (but far from reasonable) wholesale prices.

Generation

"The only long-term solution to this problem is to build more generating capacity. This is the cornerstone of my comprehensive plan to fix California's deregulation disaster. Prices won't fall and supply won't be truly reliable until we generate more power than we consume."

— Governor Gray Davis

For the 12 years before Governor Davis took office, not a single power plant was built in our state. Not one.

But, beginning in April 1999, the Davis Administration righted the course, moving expeditiously to bring plants on-line.

It cut approval times in half and licensed 16 major power plants. 10 are under construction. Four will be online this summer. The Davis Administration has also approved 10 new “peaker” plants.

The Governor also signed legislation establishing the California Consumer Power Authority to build, own and operate new power plants on behalf of consumers.

All of this, California did without weakening its historic commitment to clean air and water.

Conservation

“During my State of the State address in January, I asked all Californians to use 10 percent less electricity. Some critics said it couldn’t be done. But Californians have conserved in heroic fashion. Californians used 11 percent less electricity in May and 12 percent less in June, including 14 percent less electricity during peak. That’s a tremendous effort on the part of our state.”

-- Governor Gray Davis

While we augment our energy supply, we’re also reducing our demand, setting new national standards for energy efficiency.

In April, Governor Davis signed an $850-million conservation program – the nation’s largest – into law.

This followed his Executive Order, offering a 20-percent rebate to consumers and businesses that conserved 20 percent during the summer months of 2001.

In addition to reducing its own energy use up to 25 percent, the state has entered into conservation partnerships with hundreds of companies, business associations and local governments.

The measures have had an immediate impact.

In May alone, Californians conserved 11 percent, enough electricity to power the entire San Diego Gas and Electric service area at peak.

Today, California is the most electricity efficient state in America. And it's conserving more every day.

Stabilization

"Our first priority must be providing reliable, reasonably priced energy to power our homes and businesses."
— Governor Gray Davis

On January 17, 2001, the State of California stepped in to purchase the power the utilities could no longer afford to buy. As a result, the state was able to keep the power on and the economy growing.

Since then, we've moved aggressively to lock up long-term power at lower prices and, as a consequence, reduced our reliance on the volatile spot market.

Governor Davis has used his emergency powers to seize control of existing low-cost contracts that the utilities intended to forfeit to the generators.

Since the Administration began purchasing power, the average price paid per megawatt hour has dropped.

Of course, a stable energy market requires viable utilities.

The state has worked to restore the utilities to financial stability.

On April 9, 2001, the state announced a Memorandum of Understanding with Southern California Edison on the key principles of a balanced recovery agreement.

In June, the state negotiated an agreement between Edison and the state's "Qualifying Facilities" that will increase supply and bring back on-line facilities that were shut down because of economic reasons. It is estimated that the agreement will save the state $100 million by the end of 2001.

On Monday, June 18, 2001, the state announced a second MOU – with San Diego Gas & Electric. This time, California negotiated a $747-million balloon payment owed by San Diego ratepayers down to zero, with no increase in rates.

Demand for Federal Action

California continues to address the energy crisis in a variety of ways. The state's available resources have been pressed into service. California is doing its part: generation, conservation, stabilization.

Since the Federal Power Act of 1935, wholesale price regulation has been the exclusive domain of the federal government.

The law requires FERC to protect consumers from "unjust and unreasonable" electricity prices.

FERC has already made this determination in two separate orders, dated November 1 and December 15, 2000.

Despite these findings, FERC lifted the hard price cap of $250 per megawatt hour that had been in effect, allowing the energy companies to set their own prices.

The result is that the same electricity that cost Californians an average of $30 a megawatt in the spring of 2000 skyrocketed to $1,500 for the same megawatt of power this spring on the spot market.

At one point in January, Duke Energy charged the state an outstanding per-megawatt record of $3,880, and just last month, Reliant Energy charged $1,900 per megawatt.

Exorbitant prices aren’t limited to electricity.

In November 2000, natural gas prices in California began diverging from the rest of the nation.

Since then, California has faced natural prices 2-3 times higher than the national average.

Californians believe in free enterprise. But, the fact is that California’s energy market is not a “free” market.

Power generators and sellers are able to exert market power over California’s energy market, driving up prices.

A recent study by the California Independent System Operator identified a huge price markup over the competitive cost of electricity in the months of March, April and May of this year.

In other words, there were forces greater than supply and demand contributing to the artificially high price of electricity during those months. That force was market power.

As a result, unplanned outages within privately-owned power plants have increased exponentially. By taking plants off-line, generators are able to suppress supply.

During January-April 2000, the average number of megawatts held off-line ranged from 2,400 to 3,400. During the same period this year, the average was nearly 10,000 in January, 11,000 in February, 14,000 in March, and 15,000 in April.

In addition, the state Department of Water Resources has reported that off-line capacity this June is running at a much higher level than in previous years.

The result is that in 1999, California paid roughly $7 billion for all its electricity. Last year, the figure shot up to $27 billion. This year, even though we're using <u>less</u> electricity, estimates suggest total spending may hit $50.

Cal ISO, the agency that runs California's power grid has identified approximately $9 billion in overcharges to California, much of it from out-of-state energy companies who clearly manipulated the system.

Because the outrageous prices charged by the energy companies have crippled two of our largest utilities, the state has been forced to step in and pay $7 billion out of its treasury to cover the costs of electricity.